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No. 86-781

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

KANSAS GAS AND ELECTRIC COMPANY,
Appellant,

v.

STATE CORPORATION COMMISSION OF
THE STATE OF KANSAS,
Appellee.

On Appeal from the Supreme Court of Kansas

APPELLANT'S REPLY TO MOTION TO AFFIRM OR DISMISS

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Appellee has filed a Motion to dismiss this appeal for want of substantial federal question or, in the alternative, affirm the judgment of the Kansas Supreme Court. This Court should overrule that Motion and allow plenary review.

ARGUMENT

The majority of Appellee's arguments do not merit a reply, so Appellant Kansas Gas and Electric Company (KG&E) will not address each point in Appellee's Motion.

A. The Proper Issue Is Whether KG&E's Property Was Confiscated.

The Kansas Corporation Commission (KCC) confiscated KG&E's property by denying KG&E's investors *any* return on 78 percent of KG&E's prudent investment

in Wolf Creek.[1] Appellee does not dispute that fact. Instead, Appellee argues that because KG&E will recover 90 percent of the cost of constructing Wolf Creek over its 30 year life, KG&E's investors have not been harmed and KG&E's property has not been confiscated. Appellee is mistaken. No investor would consider himself unharmed if his original investment were paid back ratably over a 30 year period, with no return on 78 percent of that investment. The purpose of investing is to earn a return on funds invested. KG&E's investors have been denied the time value of 78 percent of their funds invested in Wolf Creek. The impact of the 78 percent denial is greatly magnified because it must be borne entirely by KG&E's common shareholders. KG&E's common shareholders are penalized $95 million *each year*, a large penalty for a company with a total equity capitalization of only $800 million.

Under Appellee's theory of regulation, KG&E's ratepayers will receive the benefits of investors' funds over a 30 year period and will not pay a return on 78 percent of the amount originally invested. This unique method of regulation does not comport with the traditional regulatory bargain or the standard set forth in *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944). Traditional regulation and *Hope* require consideration of both ratepayers' and investors' interests.

Under *Hope*, the interests of ratepayers and investors must be balanced. The investor interest, as discussed in *Hope*, is a "return to the equity owners . . . commensurate with returns on investments in other enterprises having corresponding risks." 320 U.S. at 603. Further, the return "should be sufficient to assure confidence in the financial integrity of the enterprise." *Id.* The KCC,

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[1] This denial of return was effected in large part by a revaluation disallowance not based on a finding of imprudence, nor on a finding that the plant should have been cancelled.

in allowing KG&E to earn an equity return of only one percent (see Appellant's Jurisdictional Statement at 15), did not provide a return to KG&E's owners commensurate with other enterprises. The KCC did not balance the interests of investors and ratepayers, but rather provided all of the benefits to ratepayers and none to investors. Allowing KG&E to recover, over a 30 year period, 90 percent of the costs incurred in constructing Wolf Creek, without an adequate return for the use of the funds invested, is confiscatory.

B. The KCC Denied KG&E Procedural Due Process.

Appellee admits that "[t]here is no doubt that under the fourteenth amendment KG&E has the procedural rights to notice and an opportunity to be heard," (Motion To Affirm Or Dismiss at 17) but argues that KG&E's procedural due process claim "is legally without merit and factually false" (*id.* at 16). If KG&E has the legal right to due process, its claim has legal merit. The actual dispute, therefore, is the factual question or whether KG&E was afforded due process. Because the Kansas Supreme Court did not address KG&E's claim, review by this Court is necessary and proper.

Appellee claims that KG&E had an opportunity to present evidence about valuing Wolf Creek as a coal plant because this valuation method was "suggested by Intervenor Mary Margaret Rogers." (Motion To Affirm Or Dismiss at 16). This argument does not address the issue. No evidence on using the assumed cost of a hypothetical coal plant as the basis for valuing Wolf Creek was presented at the hearings before the KCC. Intervenor Rogers, one of 475 public witnesses, did not present any testimony, let alone expert testimony, on the valuation of Wolf Creek. The suggestion of Intervenor Rogers was first made in a post-hearing brief, without any supporting record evidence. Appellee's reliance on an unsupported, non-evidentiary post-hearing "suggestion" as

satisfaction of KG&E's right to procedural due process is misguided.

Appellee also argues that KG&E presented "considerable evidence concerning the value of Wolf Creek." (*Id.*). KG&E did not have an opportunity to present evidence on the issue of the measure of value adopted by the KCC for Wolf Creek. KG&E's evidence concerned the amount of its prudent investment in Wolf Creek and a rebuttal to the life-cycle valuation analysis proposed by a Staff witness. This is not equivalent to evidence on the use of the assumed cost of a hypothetical coal plant as a surrogate measure of value for Wolf Creek.

KG&E's evidence concerning the use of life-cycle analyses for valuation purposes persuaded the KCC not to use such an analysis. The KCC stated that life-cycle analyses "required too many long-term projections to be appropriate for a precise valuation of the plant."[2] (*Id.* at 8). Thus, KG&E addressed and repudiated the sole alternative to historic cost ratemaking proposed during the proceedings and was denied the opportunity to address the methodology ultimately adopted by Appellee. That denial violates KG&E's right to procedural due process.

Appellee argues that KG&E received procedural due process because it "argued against the valuation method ultimately chosen by the Commission during the rehearing proceeding." (*Id.* at 17). Appellee's suggestion that KG&E was granted rehearing on this issue is a misstate-

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[2] After rejecting in its Order the use of a life-cycle analysis, Appellee now argues that the method of valuation ultimately adopted "is a combination of the life-cycle analysis proposed by Dr. Rosen (a staff witness) and the bus bar cost analysis used by the utilities." (Motion to Affirm or Dismiss at 16). This is merely an *ex post* rationalization of its Order. Further, KG&E did not present the bus bar cost analysis as a valuation method. Instead, the analysis was presented as part of KG&E's generation planning tools. There was no testimony concerning the use of bus bar cost analyses as a method of rate base valuation.

ment. KG&E was afforded its right to petition for rehearing by written motion and oral argument. KG&E's request for rehearing on this issue, however, was denied. In short, there was no rehearing proceeding. Even assuming that the denial of rehearing based on written motion and oral argument constitutes rehearing, such an *ex post* hearing does not satisfy due process. KG&E must be afforded notice and an opportunity to be heard before a decision is reached. Argument on a motion for rehearing is too late. *See Virginia Electric and Power Company v. State Corporation Commission*, 226 Va. 541, 548, 312 S.E.2d 25, 29-30 (1984).

C. The Used and Useful Test Does Not Justify the KCC's Actions.

To justify the KCC's rate order, Appellee cites cases in which commissions have applied a "used and useful" test to deny recovery of costs. This test requires that assets included in rate base be used and useful in serving ratepayers. Appellee would have this Court believe that the issues in this case are similar to cases involving cancelled plants, inoperable plants or plants not currently needed. This case, however, does not involve such a plant. Wolf Creek has been operating for over a year, providing energy for Kansas customers. In fact, Wolf Creek's performance in its first year set a national record by generating over 8.9 billion kilowatthours. KG&E's customers are receiving the full benefits of Wolf Creek operation at the expense of KG&E's investors.

The KCC did not merely exclude costs related to the part of Wolf Creek that it believed represents excess capacity. Rather, the KCC denied a return on a significant portion of the Wolf Creek capacity that it found was providing benefits to KG&E's customers. (See Appellant's Jurisdictional Statement at 5.) After the KCC excluded a portion of Wolf Creek from recovery because it found the capacity unnecessary to serve KG&E's demand, the KCC went even further and valued the portion of Wolf

Creek that it found necessary to serve KG&E's customers at an "economic value" that is less than half of the plant's actual cost. Revaluation of the portion of Wolf Creek needed to serve KG&E's customers—the portion that is undeniably used and useful—is improper and arbitrary.

The essence of Appellee's argument is that the ratemaking theory of "used and useful" takes precedence over the constitutional requirement of just compensation. Appellee asserts that "reasoned regulatory principles such as 'used and useful' do not yield to the financial interests of utilities." (Motion To Affirm Or Dismiss at 22.) Protection of property from confiscation is not merely a "financial interest of utilities," it is part of the constitutional protections accorded by the Fifth Amendment. Appellee, however, believes that the KCC's finding of "economic excess capacity" justifies the confiscatory result achieved. This is misguided.

A regulatory body may choose among alternative ratemaking formulae, but the choice must not be applied arbitrarily. In the present case the KCC applied its economic revaluation arbitrarily to Wolf Creek and not to any of KG&E's remaining assets, nor to the assets of any other Kansas utility. This unique valuation method resulted in the lowest possible rate base valuation for Wolf Creek. The result achieved is also confiscatory. The return allowed by the KCC is so low as to fall below the permissible zone of reasonableness.

CONCLUSION

The questions presented in KG&E's Jurisdictional Statement are substantial and require plenary consideration. Therefore, Appellee's Motion To Dismiss Or Affirm should be denied.

Respectfully submitted,

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